

Box 1.1**Ten years after re-unification : a review**

10 years after the re-unification, Hong Kong economy is now in an excellent shape, with high economic growth and low inflation. Our per capita GDP reached a new high of US\$27 700 last year. Trade continued to prosper at double digit growth pace in the past four years. Financial sector activities are vibrant as ever. Employment is now at an all time high. But it has not been plain sailing. Hong Kong went through a serious downturn immediately after the handover. Between 1997 and 2003 we were hit successively by three severe shocks. First was the outbreak of the Asian Financial Crisis, which pushed the economy to its first real recession ever since the GDP series was published and triggered a deflationary spiral that lasted for almost 6 years. Then, the bursting of the IT/nasdaq bubble in 2000 and the subsequent global economic slowdown in 2001 completely derailed the recovery process then in Hong Kong. Then, the outbreak of the SARS in 2003. Each time round, Hong Kong was able to recover swiftly, thanks to the resilience and determination of Hong Kong people, and also the entrepreneurship of the corporate sector and the government's "Big market, small government" policy.

Since mid-2003, the economy was back on a strong upturn. Confidence has returned, and by now the economy has been on a broad-based and strong upturn for 15 consecutive quarters. The performance in the past three years has been truly remarkable, not just in terms of the speed and strength to which the economy has turned around, but also in terms of the broad-based employment growth and the benign inflation thus far.

Apart from the cyclical ups and downs, the Hong Kong economy also went through significant economic restructuring, partly triggered by the downturn, but a lot was also our response to the changing economic scene in Asia. Because of the rising prominence of the Mainland economy, China has now become a big market on its own. While this has brought about tremendous business opportunities to Hong Kong's service sectors, it also poses challenges. Economic integration with the Mainland economy which is very competitive in cost terms will mean that Hong Kong has to go up the value chain and move towards high value added activities like financial and professional services. So, in the process, Hong Kong has made significant progress in financial, trade, logistic, tourism and professional services. The city is consistently ranked as the world's freest economy. We are also the preferred regional centre for commerce and trade, and more than 3 800 foreign companies have chosen Hong Kong as regional HQ/representative office, 53% more than 1997. Look at the mix of jobs today, the number of jobs belonging to the higher skilled category surged by 34% over 10 years ago.

Today, the Hong Kong economy is dynamic as ever. Trade as a % of GDP was 400% in 2006, up from 259% in 1997. And with the strong partnership between China's manufacturing base with Hong Kong's services, the importance of services in our economy has grown even more—they are now 91% of GDP, up from 86% in 1997. Economic links between Mainland and Hong Kong have grown by leaps and bounds, and reached unprecedented highs year after year following the implementation of the CEPA.

Box 1.1 (Cont'd)

Mainland factor in propelling Hong Kong's economic development

The Mainland factor is now prominent everywhere in Hong Kong, in trade, in investment, in stock market, in tourism, in financial service business. But our role in China's economic development is very much a dynamic one, as Hong Kong is constantly evolving and searching for new opportunities in a thriving Mainland economy and in an era of globalization:

- On the trade front, Hong Kong has always been the fore-runner of global outsourcing, and as early as the 1980s our manufacturers have started relocating to South China. Today, China is not only important as our production hinterland, it is also our biggest market, more than the combined share of US and Europe even if the stream of exports for outward processing is taken out.
- Hong Kong is always a gateway for companies to go into China. This role is still prominent. Now, our new role is to help Mainland companies to reach out to the world and get to know international best practices.
- In the area of financial services, in the 1980s Hong Kong was already the most important international banking/funding centre for the Mainland. Through the years, the range of financial services has diversified from bank syndications to IPO and asset management. Hong Kong is now a premier IPO centre for Mainland companies, with over half of market capitalization of the HKSE related to Mainland companies. While the listing of H shares has provided significant business opportunities for the financial market here, it has also widened the breadth and the depth of our stock market and attracted more international investors to Hong Kong.
- In terms of capital flows, our role has always been to help channel investment and capital into China. Now, with China's economic development advancing fast, domestic financial intermediation needs on the Mainland are not only huge but also growing. How to improve the effectiveness of domestic financial intermediation in the Mainland is a challenge. Hong Kong can assist in this process, to facilitate the outward mobility of capital from the Mainland in a controlled and orderly manner. The QDII is obviously one such channel.

Thanks to the "One Country, Two systems" arrangement, a great extent of the pre-unification system has extended into the post-unification era. The rule of law – the key to economic success – is well protected. The economic system continues to exhibit a high degree of dynamism. The Mainland factor is adding and no doubt will continue to add vitality to the Hong Kong economy, prompting Hong Kong to move up the value chain and restructure itself to become the international financial and business hub for the Mainland.

Box 1.1 (Cont'd)**Comparison of the economic situation in 2006 with 1997**

	<u>2006</u>	<u>1997</u>	Change <u>over 1997</u>	Remarks
<i>(a) Economy expanded significantly in size with stronger fundamentals and better outlook</i>				
GDP (nominal)	\$1.47 trillion	\$1.37 trillion	8%	
Real GDP	-	-	43%	
Real GDP growth averaged over past 3 years	7.7% p.a. (2004-06)	4.4% p.a. (1995-97)	-	Fastest above-trend growth for 3 consecutive years since 1987.
Per capita GDP (nominal)	\$215,010 (US\$27,680)	\$210,350 (US\$27,170)	2%	Slightly higher than 1997 level, but notably higher in purchasing power terms after adjusting for consumer price movement
<i>(b) Benign inflation</i>				
Consumer price inflation	2.0%	5.8%	-	Lower inflation rate.
CPI inflation averaged over past 3 years	0.8% p.a. (2004-06)	7.1% p.a. (1995-97)	-	The current high-growth-low inflation macroeconomic environment is the best performance in recent history.
<i>(c) Buoyant labour market</i>				
Average labour earnings in real terms (Index, Q1/1999 = 100)	107	89	21%	Real earnings increased by one-fifth.
Total employment ('000)	3 410	3 164	8%	Hit successive record highs during 2006.
Share of employed persons with tertiary education	30.4%	22.3%	Up 8.1 percentage points	Stronger pool of talents.
Share of employed persons in professional and managerial grade	36.3%	29.5%	Up 6.8 percentage points	Transformation towards knowledge-based economy with more higher end jobs.

Box 1.1 (Cont'd)

	<u>2006</u>	<u>1997</u>	Change over 1997	Remarks
<i>(d) International financial centre status becoming more important</i>				
Hang Seng Index (period-end)	19 965	10 723	86%	Hit record high and broke the 20 000 level in late 2006.
Stock market capitalization (US\$ billion, period-end)	1,715.5	413.5	More than quadrupled	Ranked 6 th in the world [#] at end-2006, up from 9 th at end-1997.
Capital raised in IPO (US\$ billion)	42.9	10.5	308%	Ranked 2 nd in the world [#] in 2006, after London.
Average daily stock market turnover (US\$ billion)	4.4	2.0	119%	More vibrant trading activities.
Number of listed companies (period-end)	1 173	658	78%	Premier fund raising centre in the region.
Foreign reserves (US\$ billion)	133.2	92.8	44%	Better equipped to withstand external shocks.
Pass loan as a share of total loans (period-end)	96.65%	94.21%	Up 2.44 percentage points	Higher asset quality of banks.
Share of financial services industry in GDP	12.7% (2005)	10.3%	Up 2.4 percentage points	Rising importance of financial services sector in the economy.
<i>(e) A more complex, dynamic and diversified economy – an international hub for trade & logistics, shipping, business services and tourism</i>				
Ratio of total trade in goods and services to GDP	400%	259%	-	Even more open and closely integrated with the global economy.
Port cargo throughput (million TEUs)	23.5	14.4	64%	Record high in 2006.
Air cargo throughput (million tonnes)	3.6	1.8	doubled	Record high in 2006. A regional air transport hub.
Share of trading and logistics sector in GDP	28.6% (2005)	21.9%	Up 6.7 percentage points	Increasing contribution of trade and logistics activities in GDP.
Incoming visitors (million)	25.3	11.3	more than doubled	Record high in 2006; both Mainland and other visitors increased.
No. of regional headquarters and regional offices	3 845	2 514	53%	Ranked 6th in the world in terms of FDI inflows in 2005.

Box 1.1 (Cont'd)

	<u>2006</u>	<u>1997</u>	Change <u>over 1997</u>	Remarks
No. of work visas issued to non-Mainland workers	21 958	16 561	33%	Visas approved under the General Employment Policy. Indicative of a cosmopolitan city.
<i>(f) Transformation towards a knowledge-based economy and information society</i>				
R&D expenditure				
- \$ million	10,908	5,603	95%	Growing importance of R&D activities in the economy.
- As a share of GDP	0.79% (2005)	0.43% (1998)	0.36 percentage points	
Share of business establishments with internet connection	55.9%	37.3% (2000)	Up 18.6 percentage points	More widespread use of technology to enhance competitiveness.
Internet traffic volume - customer access via broadband networks (terabits since 2001)	7 794 032	73 607 (2001)	106 times	More efficient and effective flow of information within the territory and with the rest of the world.
<i>(g) Much more integration with the fast growing Mainland economy</i>				
Total trade with the Mainland (HK\$ billion)	2,349	1,116	more than doubled	The Mainland is Hong Kong's largest trading partner and Hong Kong is Mainland's 3rd.
Stock of Mainland's FDI from HK (US\$ billion, period-end)	280	120	more than doubled	Hong Kong is the largest external investor in the Mainland.
Mainland visitors (million)	13.6	2.4	5.7 times	Hong Kong is the most favoured destination for Mainland visitors.
No. of Mainland enterprises listed in Hong Kong (period-end)	367	101	3.6 times	Accounting for almost one-third of the total number of listed companies.
Market capitalization of Mainland enterprises listed in Hong Kong (US\$ billion, period-end)	863.6	67.4	12.8 times	Accounting for half of the total market capitalisation.
No. of work visas issued to Mainlanders	5 782	219	26.4 times	Including Mainland residents and also PRC passport holders residing overseas for at least one year before submission of visa application.

Box 1.1 (Cont'd)

	<u>2006</u>	<u>1997</u>	Change over 1997	Remarks
(h) Socio-economic progression with higher living standard, continuous investments in public services and better safety net				
Standardised death rate per 1 000 population	5.4	6.5	Down 1.1 percentage point	General improvement in health care.
Infant mortality rate per 1 000 known live birth	1.8	3.9	Down 2.1 percentage points	General improvement in health care.
Average living space of public housing tenants (sq. m. per person)	12.0	9.5	26.3%	Improving living environment for PRH tenants.
Average waiting time for public housing applicants (years)	1.9	6.6	Reduced by 4.7 years	More timely provision of PRH to those in need.
Public expenditure on health - \$ million - As a share of GDP	31,616 2.3% (2005/06)	27,954 2.0% (1997/98)	13.1% Up 0.3 percentage point	Increased investments in health.
Number of hospital beds per 1 000 population	5.0	4.7	Up 0.3	
Number of doctors per 1 000 population	1.7	1.4	Up 0.3	
Share of population aged 15+ - with no schooling/ kindergarten education - having received tertiary education	7.1% 23.0%	9.3% 17.2%	Down 2.2 percentage points Up 5.8 percentage points	Rising educational attainment of the population.
Public expenditure on education - \$ million - As a share of GDP	53,911 3.9% (2005/06)	47,402 3.5% (1997/98)	13.7% Up 0.4 percentage point	Heavier investments in human capital.

Box 1.1 (Cont'd)

	<u>2006</u>	<u>1997</u>	Change <u>over 1997</u>	Remarks
Pupil-teacher ratios				
- Primary day school	17.6	22.8	Down 5.2	General improvement in education.
- Secondary day school	17.1	20.0	Down 2.9	
Public expenditure on social welfare				
- \$ million	33,262	21,335	55.9%	Better safety net for those in need.
- As a share of GDP	2.4% (2005/06)	1.6% (1997/98)	Up 0.8 percentage point	

Note :

(#) Estimated figure based on latest available information.